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Executive Summary:

First you stop digging: Projections of Illinois' fiscal imbalance and paths to remedy it

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For many years, Illinois has operated with a structurally imbalanced budget. That is, under the policies in place at any given time, state government revenues generated by the tax system were insufficient to pay for its expenditures. We have combined spending and revenue data supplied by the Illinois Comptroller with our Fiscal Futures budget model to quantify past and current budget gaps (deficits or surpluses) and to project future budget gaps, given current law. We find:

1. A deficit of approximately $13 billion for FY2017,
2. A projected deficit of approximately $14 billion per year for each of the next five years, with growing deficits through at least 2027,
3. "Legacy costs" for unfunded liabilities for retiree pensions and health care of $174 billion, and
4. Unpaid bills for services already provided to the state of $10 billion.

We believe that current policy is not sustainable because it would require extreme forbearance from Illinois' suppliers and creditors. So we examine five potential alternatives, first separately and then in combination.

Spending cuts. We separate spending into non-discretionary and discretionary components. Non-discretionary components include pension payments, debt service etc. We assume no change in non-discretionary spending but assume that the annual rate of growth of discretionary spending is reduced two percent per below current policy after 2015. As a result of these cuts, by 2027 discretionary spending would be about 20 percent below our baseline projections. The cuts would have a modest initial effect, causing the budget deficit to fall (relative to projections) by $900 million in FY2017. The impact would grow over time, but these cuts would still leave a budget deficit of more than $15 billion annually in FY2027

Income tax rate increase. We simulate an increase in the personal income tax rate to 4.75 percent from the current 3.75 percent and an increase in the corporate income tax rate to 6.65 percent (from the current 5.25 percent) effective January 1, 2017. This would reduce the budget gap by $4.2 billion in FY2018. However, because the increase in the tax rate alone does nothing to change the rate of growth of either revenue or expenditures, revenue would grow more slowly than expenditures, so that by FY2027 the budget gap would be more than $14 billion annually.

Income tax base increase. We project a 10 percent expansion of the income tax base which could be achieved by taxing some sources of income, such as retirement income, that are now excluded. Under this scenario, in FY2018, the projected deficit is reduced by $1.6 billion. We project that the amount of the reduction in the budget gap would grow slightly over time but that the percentage reduction would decline as spending continues to grow faster than revenue.

Sales tax base increase. We project the revenue impact of a 15 percent increase in the base of the general sales tax, perhaps obtained by extending that tax to a limited range of services. Sales tax base expansion would result in a deficit of $12 billion in FY2018. Because this would do nothing to change the rate of spending growth and only slightly change the rate of revenue growth, we project that the budget deficit would continue to grow and reach $20 billion in FY2027.

Increasing Illinois' underlying economic growth rate. Here, we assume that through some combination of policies and improved business and consumer confidence, Illinois is able to achieve an extra one-half of 1 percent growth in personal income each year starting in FY2018. We project that such growth would have a very modest fiscal impact: the budget gap would fall by just $100 million in 2018 and, by the end of the decade, the budget gap would be just $1.5 billion lower than the baseline.

Combined effect of multiple policies. Thus, none of the individual policies we examined would, by itself, be sufficient to close the budget gap within the next decade. However, our model projects that the combined effect of all these changes taken together could be just enough to close the budget gap, if we implement these policies soon and maintain them over at least the next decade. Our projections of these combined policies suggest that the budget gap would fall from $9.4 billion in 2017 to $2 billion in 2021. Continued vigilance would be necessary, however, since the reversal of these policies could easily create a situation where revenue once again grows more slowly than expenditures resulting in a new and widening budget imbalance.

Conclusion. We see no plausible path to sustained fiscal stability without significant and broad-based sacrifice. Illinois will need to increase revenue and slow the growth of spending simultaneously. However, this fiscal austerity alone will not guarantee success. Increasing revenue, especially through taxation, could discourage economic activity and be counter-productive in the long run. Any revenue enhancement policy should be carefully thought through and be consistent with continued vibrant economic activity. Similarly, budget cuts could be counter-productive if they neglect social problems that fester and end up costing even more to deal with in the long run. Finally, budget cuts to services essential to the smooth operation of the economy could reduce economic activity and ultimately lead to even larger budget gaps.